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NO. 72-1145

IN THE

Supreme Court of the United States

OCTOBER TERM, 1972

J. A. NEWSOME, JR., *Petitioner*

v.

UNITED STATES OF AMERICA, *Respondent*

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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J. A. Newsome, Jr., your petitioner, (hereinafter sometimes called taxpayer) prays that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Fifth Circuit in the above case entered November 22, 1972.

OPINION BELOW

The instant case was originally tried in 1968 in the United States District Court for the Southern District of

Texas, Houston Division, and was decided in favor of taxpayer; upon appeal by the Government, the United States Court of Appeals for the Fifth Circuit reversed and remanded the case for further trial. (The Fifth Circuit's first opinion is reported at 431 F.2d 742; that Court's opinion upon taxpayer's application for rehearing is reported at 431 F.2d 749; these two opinions are reproduced as Appendices A and B, *infra*). Upon further trial in the district court, judgment was entered (copy reproduced as Appendix C, *infra*) without formal findings of fact and conclusions of law. Upon appeal by both taxpayer and the Government the Fifth Circuit affirmed *per curiam* the district court's judgment. (Copies of the Court of Appeals' second opinion and its judgment are reproduced as Appendices D and E, *infra*).

JURISDICTION

The jurisdiction of this Court is invoked under 28 U.S.C. Section 1254(1).

QUESTION PRESENTED

Whether under Section 6672 of the Internal Revenue Code of 1954,[1] taxpayer (a corporate officer) may be surcharged as a trustee and thus become personally liable to the Government for corporate employees' payroll taxes withheld but not paid over to the government, in circumstances where taxpayer made no willful preferences of any creditors over the Government.

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1. 26 U.S.C. Sec. 6672. Unless the contrary is indicated all statutes hereinafter cited are in the Internal Revenue Code of 1954; parallel citations appear in Title 26 United States Code under the same section number.

STATUTORY PROVISIONS INVOLVED

This case involves a construction of Sections 6671, 6672, and 7501 of the Internal Revenue Code of 1954, which are reproduced in Appendix F, *infra*.

STATEMENT OF THE CASE

This case involves a question of whether taxpayer is liable for a 100 per cent penalty assessment made against him pursuant to Section 6672 because of his alleged "willful failure to pay over" to the Government certain payroll taxes withheld by New Wolf Construction Company ("New Wolf") for the fourth calendar quarter of 1961 and January of 1962. Federal jurisdiction was invoked in the trial court pursuant to 28 U.S.C. Section 1346.

In mid-1960 New Wolf commenced the business of constructing oil and gas pipeline facilities; taxpayer, Wolfinger and Mrs. Mixon, who were respectively president, vice president and secretary-treasurer, along with four others contributed $60,000 of capital to the company. Taxpayer and Wolfinger between them had about 50 years of experience in the construction business, and divided between them all engineering and construction activities. During the term of New Wolf's existence, (mid-1960 through early 1962) Wolfinger and taxpayer traveled constantly through Texas, Louisiana, New Mexico, Oklahoma, Indiana, Montana and several other states.

Because taxpayer and Wolfinger were required to be on the road constantly, and because of their inexperience in office administration and financial matters, they arranged for a prominent Houston CPA firm to set up and

supervise New Wolf's internal fiscal record keeping procedures; Mrs. Mixon was to perform all of the day-to-day fiscal and administrative work. Ultimately the CPA firm took over all bookkeeping functions, the work being performed at the CPA's office.

From the inception of New Wolf through November and into December of 1961 the company was doing business as usual, performing work, receiving payments, and paying bills when and as they were due. All required tax returns were prepared and filed timely and all taxes due were timely paid. At the end of December 1961, taxpayer and Wolfinger were presented financial statements of New Wolf as of November 30, 1961, prepared from the books maintained by the CPA. The balance sheet reflected current assets of $43,000 more than the current liabilities and total assets of $77,000 more than all liabilities. The profit and loss statement reflected $67,000 of profit for the six month period ending November 30. Taxpayer's state of mind respecting the company's fiscal situation during December of 1961 and January of 1962 was based on these financial statements.

At no time prior to January 29, 1962, was there any suggestion or thought that New Wolf would be unable to pay all of its liabilities in full when and as they became due. Late on January 29, Mrs. Mixon advised taxpayer that she had just finished preparing the federal payroll tax return of the fourth quarter of 1961, that it reflected a liability of $31,176 and that the company did not have sufficient cash in the bank account to cover that amount. Taxpayer was shocked. Thinking the tax return had been miscalculated, he called the CPA and asked for assistance. The CPA furnished a man the next day

(January 30). At the same time taxpayer set about trying to collect New Wolf's accounts receivable so as to pay the taxes by January 31. He believed that he would be able to do so.

On January 31, 1962, (two days after taxpayer learned of the crisis) New Wolf had to file the fourth quarter 1961 payroll tax return and pay over the $31,176 of taxes. Taxpayer consulted further with the CPA and then with New Wolf's regular lawyer. The lawyer came to New Wolf's office and after being informed of the situation, wrote a letter for taxpayer's signature explaining that funds would be available within a few days to pay the $31,176.

After becoming aware of the crisis on January 29, 1962, taxpayer only disbursed $410 of company funds and this was done to "hold things together." Meanwhile, New Wolf's lawyers, having learned of New Wolf's inability to pay the payroll taxes on January 31, contacted their other client, New Wolf's bank, and advised *that* client of the situation because the law firm knew that the bank had loaned New Wolf money.

The bank took over the operations of New Wolf after February 14, 1962, (with no advice to taxpayer) and continued to operate the company through the end of March. The bank's CPA discovered that New Wolf's CPA had made errors in the November 30, 1961, financial statements; instead of profits of $67,000, New Wolf had losses of $53,000 and New Wolf's current assets were overstated by $120,000. Taxpayer was never informed of these facts and had nothing to do with the manage-

ment of New Wolf or the conduct of its affairs after February 15, 1962.

New Wolf did not pay either the fourth quarter 1961 payroll taxes of $31,176 or the payroll taxes for the first quarter of 1962. The Internal Revenue Service assessed such taxes against taxpayer under Section 6672. Taxpayer paid some of the assessment and sued for refund. The Government counterclaimed for the unpaid balance.

The district court first found that taxpayer was a "person" with the meaning of Sections 6671 and 6672 but exonerated him from liability upon the fact finding that he never willfully preferred creditors of the corporation over the Government. In its opinion the district court stated to be "willful" within the meaning of Section 6672 (and thus liable to the Government under that section) "it is necessary that the person involved voluntarily, consciously, and intentionally pay creditors instead of the United States at a time when he knew that making such payments would produce a preference."

The Government appealed from the district court's judgment to the United States Court of Appeals for the Fifth Circuit. In reversing and remanding the case for further trial, the Fifth Circuit held that the payroll taxes were a trust fund belonging to the Government and that taxpayer, as trustee of that fund, is personally liable to the extent he disbursed those trust funds to pay creditors, even though taxpayer did not know that the disbursement had the effect of preferring creditors over the Government.

After further trial in the district court a dollar judgment was entered against taxpayer, and both the Government and taxpayer appealed to the Fifth Circuit. In the second appeal, taxpayer urged the Court of Appeals to

return to the "willful preference" standard and to reverse its previous holding that taxpayer was liable as trustee of a trust fund for simply disbursing those trust funds to corporate creditors. The Court of Appeals affirmed, *per curiam*.

REASONS FOR GRANTING THE WRIT

I.

THE DECISION OF THE COURT OF APPEALS FOR THE FIFTH CIRCUIT IN THE INSTANT CASE IS IN DIRECT CONFLICT WITH DECISIONS OF THE COURT OF CLAIMS AND OF THE COURTS OF APPEALS FOR THE NINTH CIRCUIT AND THE THIRD CIRCUIT, AND WITH PREVIOUS DECISIONS OF THE FIFTH CIRCUIT; IT IS INCONSISTENT WITH THIS COURT'S 1971 DECISION IN *UNITED STATES V. RANDALL*.

Although the predecessor to Section 6672 was first enacted in 1924, it was not until 1959 that a United States Court of Appeals rendered a definitive opinion thereunder:[2] that landmark case (*Bloom v. United States*, 272 F.2d 215 (C.A. 9th)) set the standard that was followed by all courts in the United States until the decision in the instant case. In *Bloom*, the Ninth circuit held that a corporate officer, to be personally liable under Section 6672, must commit a "voluntary, conscious, and intentional act to prefer other creditors of the corporation over the United States." 272 F.2d at 223.

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2. The first reported case under the predecessor to Section 6672 was decided by the Supreme Court of Texas in 1949. *Paddock v. Siemoneit*, 218 S.W.2d 428.

The *Bloom* approach under Section 6672 was followed by the Ninth Circuit in a decision rendered within one day of the first opinion in the instant case. *Dudley v. United States* 428 F.2d 1196 (1970). In *Dudley*, the Ninth Circuit reversed a trial court that had imposed a "surcharge" type liability. The Government applied for rehearing in *Dudley* and its petition (copy reproduced as Appendix G, *infra*) apprised the Ninth Circuit of the Fifth Circuit's decision in the instant case. The Government pointed out that under the Fifth Circuit's principles in the instant case, Dudley would be personally liable to the Government.[3] The Ninth Circuit denied the Government's petition for rehearing. 428 F.2d 1196. It is thus clear that there is a direct conflict between the decisions of the Court of Appeals for the Ninth Circuit in *Bloom* and *Dudley* and the decision of the Court of Appeals for the Fifth Circuit in the instant case.

The Court of Appeals for the Third Circuit in 1964 adopted the *Bloom* approach to liability under Section 6672, affirming, *per curiam*, a district court opinion which held that payments made by the alleged responsible corporate officer were not "preferences" and that the corporate officer had not "consciously paid creditors" and was not "consciously and intentionally acting to prefer other creditors" over the United States. *United States v. Slattery*, 333 F.2d 844. The decision in *Slattery* is in direct conflict with the Fifth Circuit's decision in the instant case.

The Court of Claims in 1967 adopted the *Bloom* approach to Section 6672. *White v. United States*, 372 F.2d

3. The fact that under the principles of *Dudley*, taxpayer would not be liable was called to the attention of the Fifth Circuit in taxpayer's petition for rehearing of the first Fifth Circuit opinion.

513, 521 (to be willful under Section 6672 the officer must have made a "deliberate *choice* voluntarily, consciously and intentionally . . . to pay other creditors *instead* of paying the Government . . ." [emphasis added]). Since then, the Court of Claims has continued to follow *Bloom*. *McCarty v. United States*, 437 F.2d 961, 968 (1971); *Burack v. United States*, 461 F.2d 1282, 1291 (1972); see also, *Scott v. United States*, 354 F.2d 292, 295 (1965). These decisions of the Court of Claims are all in conflict with the Fifth Circuit's decision in the instant case.

Decisions by the Fifth Circuit prior to the instant case consistently followed the *Bloom* and *Slattery* rationale. *Frazier v. United States*, 304 F.2d 528, 530 (1962) (corporate officer "preferred subsequent creditors over the United States, knowing at all times his obligations to pay such taxes"; officer held liable under Section 6672); *Dillard v. Patterson*, 326 F.2d 302 (1963) (corporate officer, who consciously and intentionally made deliberate choice to pay other creditors instead of the United States when he knew that both could not be paid, held liable under Section 6672); *United States v. Hill*, 368 F.2d 617 (1966) (corporate officer, knowing of tax debt, preferred other creditors with available funds and was held liable under Section 6672). The *Frazier*, *Dillard* and *Hill* decisions by the Fifth Circuit are in direct conflict with that Court's decision in the instant case.

This decision by the Fifth Circuit in the instant case is inconsistent with the more recent decision by this Court in *United States v. Randall*, 401 U.S. 513 (1971). In resolving the instant case in favor of the Government, the Fifth Circuit reasoned that under Section 7501, withheld payroll taxes are a trust fund equitably or legally owned

by the Government. Thus when the corporate officer in charge of the trust fund (the trustee) disburses funds therefrom to pay corporate creditors, he is personally liable if the corporation is later unable to remit the payroll taxes to the Government when due. The Fifth Circuit explicitly rejected taxpayer's argument that Section 7501 was no more than a priority statute enacted to give the United States some equitable priority as to corporate assets in the event of an insolvency proceeding.

In the Government's brief to this Court in *Randall* (pp. 6-17) the Government argued that Section 7501 created a trust in favor of the United States and accordingly that the payroll taxes withheld and being administered by the trustee of that trust were either owned equitably or legally by the United States from the date the taxes were withheld. Accordingly the Government argued in this Court that the Section 7501 trust funds are not subject to any priority provisions of the bankruptcy statutes.

The thrust of this Court's holding in *Randall* is that Section 7501 is a priority statute that must be viewed in the context of other priority statutes and that Section 7501 creates no equitable or legal title in the United States to the fund. *Randall* is clearly inconsistent with the Fifth Circuit's opinion in the instant case.

Because of the patent direct conflict between the decision by the Fifth Circuit in the instant case and the decisions of the Ninth and Third Circuits, the Court of Claims, and earlier decisions of the Fifth Circuit, and the inconsistency of the instant decision with this Court's decision in *Randall*, we submit that a Writ of Certiorari should issue to the Court of Appeals for the Fifth Circuit in the instant case.

II.

AN IMPORTANT ISSUE AS TO THE CONSTRUCTION OF SECTION 6672 OF THE INTERNAL REVENUE CODE IS INVOLVED IN THE INSTANT CASE.

From 1924 until 1956 there were no decisions in United States Courts of Appeals on the Section 6672 issue.[4] From 1959 to this date the number of cases decided under Section 6672 has increased annually. In addition, hundreds of cases involving the application of Section 6672 are annually resolved by offices of the Internal Revenue Service. Within the jurisdiction of the Fifth Circuit the *Newsome* standards are used. But throughout the balance of the United States under *Bloom, Dudley,* and *Slattery* the taxes under Section 6672 are assessed and collected only and to the extent that the corporate officer willfully and knowingly preferred other corporate creditors over the United States.

There is an obvious conflict in the construction and application of Section 6672 of the Internal Revenue Code and for that reason also, this Court should issue a Writ of Certiorari to the Court of Appeals for the Fifth Circuit in the instant case.

III.

THE COURT OF APPEALS FOR THE FIFTH CIRCUIT ERRED IN IMPOSING A TRUSTEE-SURCHARGE LIABILITY ON TAXPAYER IN THE INSTANT CASE.

The present Section 6672 was enacted in 1924 and has continued from that date to be applicable to certain col-

4. The first opinion was *Gray Line Co. v. Granquist,* 237 F.2d 390 (C.A. 9th 1956).

lected excise taxes (*e.g.*, on firearms, liquor, theatre admissions, and transportation) and withheld taxes (such as social security taxes and income taxes). The liability of those persons described in Section 6672 (and its predecessors) is an *original* liability that is not predicated in any fashion upon the existence of Section 7501 or any other statute. Stated another way, if Section 7501 had never been enacted Section 6672 would still have as expansive (but no more expansive) an application as it does today.

The history of Section 7501 demonstrates its total want of applicability here. That section was first enacted in 1934 as Section 607 of the Revenue Act of 1934, c. 277, 48 Stat. 680, ten years *after* the predecessor to Section 6672. According to the Senate Finance Committee Report,[5] Section 607 was enacted to relieve a situation that developed in insolvency proceedings: in such proceedings it seems that courts had been holding that United States' claims against insolvent corporations (for collected and withheld taxes that were not yet the subject of a tax return) were unsecured; the United States thus shared in the assets of the insolvent corporation as a general creditor. Section 607 was expressly enacted to provide the United States with a sort of a priority in these insolvency proceedings.

Moreover Section 7501, by its terms, deals with the person collecting the taxes involved, *e.g.*, New Wolf. On the other hand Section 6672 by its terms deals with the person (*e.g.*, taxpayer) employed by the person (New Wolf) collecting the taxes.

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5. S. Rep. No. 558, 73d Cong., 2d Sess., p. 53.

The foregoing legislative history makes it abundantly clear that there is no historic or statutory connection or relationship between the 100 percent penalty provision (Section 6672) and Section 7501. The chronology demonstrates that Section 6672 and Section 7501 deal with different problems and have their own separate spheres of operation. There can be no doubt that Sections 6672 and 7501 are not *in pari materia.*

The Court of Appeals in the instant case treated Section 7501 as creating a trust fund of the withheld payroll taxes and then treated taxpayer as the trustee of that fund. In this fashion taxpayer was made a personal guarantor of the payroll taxes to the extent that he allowed the trust fund to fall below the accrued withholding tax liability.

Nominally the Court of Appeals imposed the liability under Section 6672. However that section imposes personal liability on a corporate office only if he *"willfully fails* to . . . pay over such tax. . . ." As we have pointed out, *supra,* other courts of appeal have consistently held that no *willful failure* to pay over payroll taxes can occur unless (1) the corporate officer knows he is put to a choice of paying either general creditors or the Government in circumstances where he knows the corporation cannot pay both and (2) that officer then decides to pay general creditors. This willful choosing to pay general creditors necessarily is a willful decision *to fail* to pay over taxes to the Government. It is a willful preference of general creditors over the Government.

The foregoing standard of liability under Section 6672 is conceptually not involved where, as here, the corporate officer consciously and intentionally pays its general credi-

tors with no notion that his action will result in a subsequent inability to pay over to the Government the withheld payroll taxes. The instant situation involves no more than an intentional disbursement of funds.

Holding a corporate officer to the high fiduciary standards of a trustee, which the Court of Appeals' decision in *Newsome* does, is completely inconsistent with the statute that imposes a civil penalty only in cases of willful failure.

For the foregoing reasons, we submit that the Court of Appeals for the Fifth Circuit erred as a matter of law in imposing the liability upon taxpayer herein.

CONCLUSION

For the foregoing reasons, the Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit should be granted.

Respectfully submitted,

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APPENDIX A

IN THE
UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 27613

J. A. NEWSOME, JR.,
Plaintiff-Appellee,

versus

UNITED STATES OF AMERICA,
Defendant-Appellant.

Appeal from the United States District Court for the Southern District of Texas

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(July 8, 1970)

Before RIVES, GOLDBERG and GODBOLD,
Circuit Judges.

RIVES, Circuit Judge: Newsome instituted this action against the United States for recovery of his partial payment of a penalty assessed against him under section 6672 of the Internal Revenue Code of 1954.[1] The assess-

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1. "§ 6672. *Failure to collect and pay over tax, or attempt to evade or defeat tax*

"Any person required to collect, truthfully account for, and pay over any tax imposed by this title who willfully fails to

ments were against Newsome, as the responsible officer of New Wolf Construction Company (New Wolf), for willfully failing to account for and pay over the social security and federal income taxes withheld from New Wolf's employees during the fourth quarter of 1961 ($31,074.81) and the first quarter of 1962 ($7,724.25). The government counterclaimed for the balance due. The district court entered judgment for Newsome. *Newsome v. United States,* 301 F. Supp. 757 (S.D. Tex. 1968). On appeal the government contends that the district court's holding—that Newsome's failure to account for and pay over the taxes withheld was not willful—is erroneous because contrary to standards of law applicable under section 6672.

The facts as found by the district court (301 F. Supp. 760, 761) are not questioned on appeal. Both parties accept the conclusion of the district court "that Newsome was a person within the meaning of §§ 6672 and 6671(b) of the Internal Revenue Code of 1954 up to and through February 14, 1962, but was not such a person thereafter" (301 F. Supp. at 761).[2]

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collect such tax, or truthfully account for and pay over such tax, or willfully attempts in any manner to evade or defeat any such tax or the payment thereof, shall, in addition to other penalties provided by law, be liable to a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over. No penalty shall be imposed under section 6653 for any offense to which this section is applicable."

26 U.S.C.A.

2. Sec. 6672 has been quoted in n. 1, *supra.* Sec. 6671 reads:

"*Rules for Application of Assessable penalties*

"(a) *Penalty assessed as tax.* — The penalties and liabilities provided by this subchapter shall be paid upon notice and demand by the Secretary or his delegate, and shall be assessed and collected in the same manner as taxes. Except as otherwise provided, any reference in this title to 'tax' imposed by this title

The gist of the district court's decision is summarized in the concluding paragraph of its opinion:

> "Viewing the record in this case as a whole, the Court is persuaded that Newsome did not wilfully fail to pay over the payroll taxes involved for the fourth quarter of 1961 and for January of 1962, in that he had reasonable cause for not paying such taxes because of his reliance upon the advice and information furnished by regularly employed accountants and attorneys, and he was not negligent in following such advice in that in following such advice he exercised the degree of ordinary care and prudence required of a man in his position and under the circumstances described."

Newsome v. United States, supra, 301 F. Supp. at 762.

This conclusion, the government argues, misapplies the standards applicable to Newsome's statutory duty to truthfully account for and pay over the taxes withheld from New Wolf's employees. The government contends that Newsome's failure to account for and pay over was "willful" within the meaning of section 6672. Its argument is twofold: (1) that before January 29, 1962, Newsome was "willful" when he permitted taxes withheld from employees' wages to be used by New Wolf to meet corporate expenses and obligations in the expectation that corporate receivables would be collected in

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shall be deemed also to refer to the penalties and liabilities provided by this subchapter.

"(b) *Person defined.* — The term 'person,' as used in this subchapter, includes an officer or employee of a corporation, or a member or employee of a partnership, who as such officer, employee, or member is under a duty to perform the act in respect of which the violation occurs."

sufficient amount to replace the expended withheld funds by the date for payment to the government; and (2) that Newsome was "willful" when he continued to use available funds to prefer other creditors after he was informed on January 29, 1962, that there were insufficient funds to remit the withheld taxes for the fourth quarter of 1961.

I.

Where, as here, the employer has collected the tax by withholding from employees' wages but has failed to pay it over to the United States, the employees are credited with payment. *Dillard v. Patterson,* 326 F.2d 302, 304 (5 Cir. 1963); *United States Fidelity & Guaranty Co. v. United States,* 201 F.2d 118, 120 (10 Cir. 1952). Unless the government has recourse for collection of the taxes withheld or an equal sum, it must suffer the loss.

While the penalty imposed by section 6672 is distinct from and not in substitution of the liability for taxes owed by the employer,[3] it brings to the government only the same amount to which it was entitled by way of the tax. The Second Circuit has stated succinctly that the penalty "is simply a means of ensuring that the tax is paid." *Botta v. Scanlon,* 314 F.2d 392, 393 (1963). Section 6672's "basic purpose is the protection of governmental revenue. * * * It provides a remedy to prevent the unnecessary loss of tax funds by permitting the 'taxing authority to reach those responsible for the corporation's failure to pay the taxes which are owing.'" *Monday v. United States,* 421 F.2d 1210, 1216 (7 Cir. 1970), and cases cited therein.

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3. Hewitt v. United States, 377 F.2d 921, 925 (5 Cir. 1967); Smith v. CIR, 294 F.2d 957 (5 Cir. 1961), *aff'g* Benjamin T. Smith, 34 T.C., 1100.

Willful

It must be remembered, however, that while the corporation is absolutely liable for the taxes withheld from its employees, the penalty imposed upon its responsible officer or employee is only for his willful failure. The word "willful" is susceptible of many meanings. As noted by this Court in *Frazier v. United States,* 304 F.2d 528, 529 (5 Cir. 1962): "As with many such issues, the definition of 'willful' has been smothered with a maze of semantics." It has been consistently held by this Court and other courts that "willfully," as used in section 6672, does not require a criminal or other bad motive on the part of the responsible person, but simply a voluntary, conscious and intentional failure to collect, truthfully account for, and pay over the taxes withheld from the employees.[4]

In many of these cases, a responsible officer's "willfullness" is established by the knowing preference of other corporate creditors over the United States *after* the due

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4. Monday v. United States, 421 F.2d 1210, 1216 (7 Cir. 1970); Gefen v. United States, 400 F.2d 476, 482 n. 7 (5 Cir. 1968); Hewitt v. United States, 377 F.2d 921, 924 (5 Cir. 1967); United States v. Hill, 368 F.2d 617, 622 (5 Cir. 1966); Scott v. United States, 354 F.2d 292, 295 (Ct. Cl. 1965); Cash v. Campbell, 346 F.2d 670, 672-73 (5 Cir. 1965); Dillard v. Patterson, 326 F.2d 302, 304 (5 Cir. 1963); Frazier v. United States, 304 F.2d 528, 530 (5 Cir. 1962); Bloom v. United States, 272 F.2d 215, 223 (9 Cir. 1959). *See also* 8A Mertens, Federal Income Taxation § 47A.25a (1964). The most recent statement by this Court is in *Gefen*:

> "We pause to restate the established principle that the term 'willful' for the purposes of Section 6672 of the Code does not require a finding of intent to defraud or to deprive the United States of taxes. It requires only that the choice to pay funds to other creditors instead of the government be made voluntarily, consciously, intentionally, and without reasonable cause." 400 F. 2d at 482 n. 7.

date[5] for the corporation to remit the withheld taxes. However, liability under section 6672 can also be premised upon use of withheld funds for other corporate purposes *before* the date for the corporation to pay over the funds.

The taxes withheld from employees' wages are held by the corporation as a special fund in trust for the United States. Section 7501; see *Monday v. United States*, 421 F.2d 1210, 1214 (7 Cir. 1970); *United States v. Hill*, 368 F.2d 617, 621 (5 Cir. 1966).[6] Although section 7501 does not require a corporation to segregate the withheld taxes from its general funds,[7] it is clear that the withheld taxes are more than simply a debt of the corporation.

Since a corporation can act only through its agents—its officers and those designated by the officers—a corporate officer or agent has a duty to see that withheld funds are properly collected from the employees, are main-

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5. Under Treasury Regulations 31.6151-1(a) and 31.6071(a)-1, New Wolf was required to pay over the withheld taxes for the fourth quarter of 1961 "on or before" January 31, 1962.

6. Section 7501 reads as follows:

"(a) *General rule.* — Whenever any person is required to collect or withhold any internal tax from any other person and to pay over such tax to the United States, the amount of tax so collected or withheld shall be held to be a special fund in trust for the United States. The amount of such fund shall be assessed, collected, and paid in the same manner and subject to the same provisions and limitations (including penalties) as are applicable with respect to the taxes from which such fund arose." Title 26, U.S.C.A.

It is clear from the legislative history and Treasury Regulations that "person" as used in section 7501 is the corporation (or other employer) collecting or withholding the taxes—not its officers. S.Rep. No. 558, 73d Cong., 2d sess., p. 53, 1939 1 Cum. Bull. (Part 2) 586, 626; Treasury Reg. 301.6672-1.

7. The corporation is required to segregate the withheld funds in a separate bank account only when specifically requested by the government. Section 7512.

tained during the quarter,[8] and are paid over to the government at the end of the quarter. This duty, for purposes of section 6672 liability, is a continuing one which arises when the federal income and social security taxes are withheld from employees' wages and ends when such funds are paid over to the United States.[9]

The responsible officer's actions before the due date for payment of the withheld taxes satisfies the "willfulness" requirement under section 6672: when the responsible officer (as defined by section 6671(b)) knows that the withheld funds are being used for other corporate purposes, regardless of his expectation that sufficient funds will be on hand on the due date for payment over to the government. Of course, the officer is only liable under section 6672 if the corporation does not pay over the withheld taxes at the date prescribed in the regulations. However, he subjects himself to liability under 6672 when he voluntarily and consciously "risks" the withheld taxes in the operation of the corporation, and subsequently the corporation is unable to remit the withheld taxes.

One example of using withheld taxes for other corporate purposes would be when, at any time during the quarter, the responsible officer is aware that the amount of corporate funds is lower than the amount of taxes withheld for the quarter and allows, or has knowledge of, the corporation's continuing tc pay other corporate creditors. See Part III, *infra.*

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8. This would encompass depositing withheld payroll taxes in a federal reserve bank as required by Treasury Regulation 31.6302 (c)-1.

9. *See* Scott v. United States, 354 F.2d 292, 295 (Ct. Cl. 1965); Long v. Bacon, 239 F.Supp. 911, 912 (S.D. Ia. 1965).

Reasonable Cause

In defining the term "willfully" this Court, although other Circuits have held to the contrary,[10] has held that "reasonable cause" is part of the civil test in determining whether the failure to collect, account for, and pay over was willful.[11] Without attempting a precise definition, we point out only that, in order to further the basic purposes of section 6672, see p. 4, *supra*, reasonable cause should have a very limited application. See cases cited in note 12, *infra*.

II.

After defining "reasonable cause" as "the failure to exercise ordinary care and prudence in connection with his actions," the district court concluded that Newsome

> "* * * had reasonable cause for not paying such taxes because of his reliance upon the advice and information furnished by regularly employed accountants and attorneys, and he was not negligent

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10. Monday v. United States, 421 F.2d 1210, 1216 (7 Cir. 1970); see 22 A.L.R.3d 88-89 (1968).

11. Gefen v. United States, *supra*; Cash v. Campbell, *supra*; Frazier v. United States, *supra*. We included the "reasonable cause" element in the meaning of "willfully" in *Frazier*:

> "We are of the opinion that 'without reasonable cause' as used in the Grandquist [sic] and Kellems cases is part of the civil test in determining whether the failure to pay was willful. * * * For the present we need only hold that in a civil case where a responsible officer paid employees their net wages at a time when the corporation had insufficient funds to cover the taxes thereon and, when such funds became available, preferred subsequent creditors over the United States, knowing at all times his obligation to pay such taxes, his failure to pay was 'without reasonable cause' and 'willful' within the meaning of section 6672."

304 F.2d at 530.

> in following such advice in that in following such advice he exercised the degree of ordinary care and prudence required of a man in his position and under the circumstances described."

301 F. Supp. at 762. Without giving approval to the court's definition of reasonable cause, we conclude that, under any circumstances, the "advice and information" which Newsome received from New Wolf's accountants and attorneys do not constitute reasonable cause for his failure to account for and pay over the withheld taxes.

The district court's finding of Newsome's reliance upon advice and information of New Wolf's accountants is apparently a reference to the June-November 1961 financial statements received by Newsome on December 27, 1961. New financial statements prepared at the direction of New Wolf's bank in March 1962 reflected that the statements prepared in December had overstated accounts receivable as of November 30, 1961 by approximately $100,000. Although it is not clear from the district court's opinion, the court's finding is premised upon the following: Newsome, after examining the financial statements on December 27, 1961, believed New Wolf would collect taxes for the fourth quarter of 1961, even though the balance sheet also reflected "cash on hand and in banks" as $7,737.59 and withheld income and payroll taxes as approximately $20,700. If the accounting firm had not overstated the amount of trade receivables, New Wolf would not have paid its creditors from December 27 through January 1962 until sufficient funds were received and the withheld taxes were paid.

The above circumstances do not constitute a "reasonable cause" for Newsome's failure to account for and pay

over the withheld taxes. Whether or not Newsome believed New Wolf had a sufficient amount of outstanding trade receivables, as of the end of the quarter, to pay the withheld taxes demonstrates only the absence of an intent to deprive the government of funds owed by New Wolf. We have previously pointed out that the element of "willfulness" does not require an intent to deprive the United States of its taxes. *Gefen v. United States, supra* at 482 n. 7; *Dillard v. Patterson, supra* at 304.

The district court's finding that Newsome relied upon the advice of New Wolf's attorney is apparently in reference to (i) the attorney's assistance in drafting a letter to the District Director and (ii) the attorney's advice on February 9, 1962, that Newsome should execute a chattel mortgage in favor of its bank. We conclude that the district court erred in holding that (i) and (ii) constituted reasonable cause for Newsome's failure to account for and pay over the withheld taxes.

In assisting Newsome to draft a letter, explaining the delay in payment to the District Director, the attorney's only advice was that Newsome send in Form 941 without payment (unless he was certain that sufficient funds were in the bank to cover the check) with the explanation that the delay was due to New Wolf's failure to collect certain receivables and that payment would be made within ten days. Newsome was not advised, nor did he interpret the advice as meaning, that he had been justified in using withheld taxes during December and January to pay other creditors or that he should continue to pay creditors with funds then available or that might become available instead of paying the government. In urging Newsome to execute a chattel mortgage on certain New Wolf equip-

ment in order to renew a note, the attorney did not advise Newsome that he could prefer the bank over the United States without subjecting himself to section 6672 liability. Although we will not attempt to explore the outer boundaries of "reasonable cause," we think it clear that the information furnished by the attorney did not constitute "reasonable cause."[12]

III.

In addition to our conclusion that the advice of New Wolf's accountants and counsel does not constitute "reasonable cause," we hold that Newsome "willfully" failed to pay over the taxes due and thus is liable under section 6672 for the taxes withheld by New Wolf during the fourth quarter of 1961.

On December 27, 1961, Newsome examined financial statements prepared by New Wolf's accountants, including a balance sheet as of November 30, 1961. Although the statements reflected that current assets ($345,266.58) exceeded current liabilities ($302,035.39), "cash on hand

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12. The term "reasonable cause" has been interpreted as advice by counsel under certain circumstances not to pay the withheld taxes as they became due, Cash v. Campbell, 346 F.2d 670, 672-73 (5 Cir. 1965); advice of non-collection by attorney and tax collector, Grey Line Co. v. Granquist, 237 F.2d 390 (9 Cir. 1956); advice by counsel that there was no tax liability, Cross v. United States, 204 F. Supp. 644, 649 (E.D. Va. 1962.) The following have been held *not* to constitute "reasonable cause": assumption that government would satisfy its tax claim out of another fund, Cash v. Campbell, 346 F.2d 670, 671 (5 Cir. 1965); mere delegation of responsibility to another, Lawrence v. United States, 299 F.Supp. 187, 191 (N.D. Tex. 1969); a presumption that the government will look elsewhere for its taxes, Spiegel v. United States, 65-2 U.S. Tax Cas. ¶ 9655 (N.D. Ga. 1965); the expectation that financial condition of business will improve, Paisner v. O'Connell, 208 F.Supp. 397, 401 (D. R.I. 1962). *See also* Frazier v. United States, 304 F.2d 528, 530 (5 Cir. 1962).

and in banks" was $7,739.59 and withheld payroll taxes were approximately $20,700 (withheld income taxes—$17,090.87; withheld F.I.C.A. taxes—$3,643.14). Thus, as of December 1, either taxes withheld from employees' wages had been used for other purposes or net wages had been paid at a time when New Wolf had insufficient funds to cover the taxes thereon. During December New Wolf made regular payroll payments. The mid-December deposit[13] for its November withholding amounted to only $2,169.65. As of December 29, 1961, New Wolf's bank statement reflected a balance of $2,073.15. With knowledge of these facts, which reflected a substantial amount of withheld taxes but only a small amount of funds, New some permitted New Wolf to pay its creditors during the month of January, apparently under the expectation that New Wolf would collect a sufficient amount of receivables to remit the withheld taxes by January 31, 1962.[14]

Under these circumstances, Newsome's conduct amounted to a voluntary, conscious and intentional action to use the withheld taxes for payments to other corporate creditors with the ultimate result of non-payment to the government.[15]

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13. These deposits were made pursuant to section 6302(c) and Treas. Reg. 31.6302(c)-1.

14. New Wolf's bank statement for January 1962 shows that deposits were made during January in the amount of $64,011.60.

15. Although the last date for payment of the withheld taxes to the government for the fourth quarter of 1961 was January 31, 1962, preference of other corporate creditors over the United States can occur before this last date for payment. *See* White v. United States, 372 F.2d 513, 521 (Ct. Cl. 1967); Scott v. United States, 354 F.2d 292, 295 (Ct. Cl. 1965); Hewitt v. United States, 377 F.2d 921, 923-24 (5 Cir. 1967). *See also* Seaton v. United States, 254 F.Supp. 161 (W.D. Mo. 1966); Long v. Bacon, 239 F.Supp. 911 (S.D. La. 1965); Tiffany v. United States, 228 F.Supp. 700 (D. N.J. 1963).

After Newsome was informed on January 29, 1962 that New Wolf had insufficient funds to remit the withheld payroll taxes for the fourth quarter of 1961, he signed and distributed checks amounting to $410.37, and distributed checks which were signed before January 29 in the amount of $1,862.54 (one of which was a payroll check for himself in the amount of $498.25). These payments clearly constitute a voluntary, conscious and intentional choice to prefer other creditors of New Wolf over the United States. *See* cases cited in note 4, *supra.*

The district court erred in entering judgment in favor of Newsome against the United States for the amount of Newsome's partial payment of the penalty, $28.00, and in further adjudging that Newsome is not liable in any amount on the government's counterclaim. The judgment is therefore reversed and the cause remanded.[16]

REVERSED AND REMANDED

16. The amount of judgment to which the government may be entitled on its counterclaim depends upon questions of law or of both law and fact not yet determined by the district court and, hence, not ripe for our consideration, for example: (1) whether the penalty provided by section 6672 is the same whenever there has been *any* willful failure to collect, or truthfully account for and pay over any part of the tax, or depends upon the amount which the responsible officer has willfully failed to collect, account for, and pay over, and if the latter, then (2) whether Newsome carries his burden of proving that the amounts of the assessments are excessive, Horwitz v. United States, 339 F.2d 877, 878 (2 Cir. 1965).

APPENDIX B

IN THE
UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 27613

J. A. NEWSOME, JR.,
Plaintiff-Appellee,

versus

UNITED STATES OF AMERICA,
Defendant-Appellant.

Appeal from the United States District Court for the Southern District of Texas

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(September 10, 1970)

ON PETITION FOR REHEARING AND PETITION FOR REHEARING EN BANC

Before RIVES, GOLDBERG and GODBOLD,
Circuit Judges.

PER CURIAM: On petition for rehearing Newsome's attorneys state: "On these facts, the Court's opinion, reversing the district court, imposes personal liability on Newsome for the payroll taxes withheld for the fourth

quarter of 1961 in the amount of approximately $31,000." That is not accurate. The amount of the judgment was left to be determined on remand. (See footnote 16 at close of original opinion.)

As their first point, petitioner's attorneys urge: "The Court has patently erred in construing Section 7501 [of Title 26, U.S.C.] to create a trust fund of withheld taxes." They argue in support as follows:

> "Section 7501 provides, as was provided in the original enactment in 1934, that withheld taxes 'shall *be held to be* a special fund in trust for the United States.' It is crucial to note that the statute says such taxes 'shall be held *to be* a special fund in trust' not 'shall be held *as* a special fund in trust.' The difference in language was intentional, for the predecessor of Section 7501 was enacted for the explicit purpose of providing the United States with a priority in an insolvency proceeding, the language being explicitly directed to courts involved in those insolvency proceedings, i.e., cash in an amount equal to the withheld taxes shall 'be held [by the courts] to be a special fund in trust,' and, upon that basis the United States would have a prior claim." (Emphasis is that of petitioner's attorneys.)

This argument is startling. We had not thought that Congress either would or could direct the courts what to hold, and we remain far from convinced. The normal way for Congress to accomplish any such purpose would be actually to impress the withheld taxes with a trust in favor of the United States. The legislative history of Section 7501(a) confirms that this was precisely what the Congress intended to do. That history was well stated by

Judge Hastings for the Seventh Circuit in *In re Halo Metal Products, Inc.*, 1969, 419 F.2d 1068, 1072:

> "The Senate Committee Report, S. Rep. No. 558, 73d Cong., 2d Sess., p. 53, noted:
>
> > " 'Under existing law the liability of the person collecting and withholding the taxes to pay over the amount is merely a debt, and he cannot be treated as a trustee or proceeded against by distraint. Section [7501(a)] * * * impresses the amount of taxes withheld or collected with a trust and makes applicable for the enforcement of the Government's claim the administrative provisions for assessment and collection of taxes.'
>
> The Conference Report, H. Conf. Rep. No. 1385, 73d Cong., 2d Sess., p. 32, reflected the same purpose:
>
> > " 'This amendment impresses taxes collected or withheld with a trust in favor of the United States and makes applicable for the enforcement of the Government's claim the administrative provisions applying to the assessment, collection, and payment of taxes.' "

Our original opinion (footnote 6) pointed out that the legislative history (and Treasury Regulations) also made clear "that 'person' as used in section 7501 is the corporation (or other employer) collecting or withholding the taxes—not its officers. S. Rep. No. 558, 73d Cong., 2d sess., p. 53, 1939 1 Cum. Bull. (Part 2) 586, 626; Treasury Reg. 301.6672-1." ____ F.2d at ____. As to the "willfulness" requirement, we held that the responsible officer "subjects himself to liability under 6672 when he voluntarily and consciously 'risks' the withheld taxes in the operation of the corporation, and subsequently the

corporation is unable to remit the withheld taxes." ____ F.2d at ____.

In their point 2, petitioner's attorneys attack that holding as follows:

> "Restated, until the instant decision, all courts of appeals have consistently held that there can be no willful failure to pay over payroll taxes to the Government unless (1) the corporate officer knows he is put to a choice of paying either general creditors or the Government in circumstances where he knows the corporation cannot pay both and (2) that officer then decides to pay general creditors."

Similarly in their point 3, petitioner's attorneys urge: "The prior decisions of this Court, heretofore cited, with clarity and uniformity established that a willful failure under Section 6672 involves a conscious preference of another creditor over the Government."

The attorneys are simply mistaken. It is true that a conscious preference of another creditor over the United States is the usual way by which a "person" becomes liable for the penalty prescribed by Section 6672. In such cases only the third and final step described in the statute, failure "to pay over the tax," is necessarily involved. The statute covers also the failure (1) "to collect such tax" and (2) "to truthfully account for" the tax so collected. If a "person" willfully fails to perform either (1) or (2), then there is no money to pay over. Hence, if Section 6672 is so construed as to limit liability for the penalty to a willful failure to pay the tax, the result in cases where there had been a failure to perform either (1) or (2) would be like locking the door of an empty garage.

Contrary to the argument of petitioner's attorneys, this is not the first decision in which the trust fund theory of Section 7501 has resulted in liability under Section 6672. *E.g., see United States v. Hill,* 368 F.2d 617, 621 (5 Cir. 1966); *Monday v. United States,* 421 F.2d 1211, 1214 (7 Cir. 1970).

We find no merit in Newsome's petition for rehearing. The Petition for Rehearing is DENIED and the Court having been polled at the request of one of the members of the Court and a majority of the Circuit Judges who are in regular active service not having voted in favor of it (Rule 35, Federal Rules of Appellate Procedure; Local Fifth Circuit Rule 12), the Petition for Rehearing En Banc is also DENIED.

APPENDIX C

IN THE
UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

CIVIL ACTION NO. 67-H-404

J. A. NEWSOME, JR.,
Plaintiff
VS.
UNITED STATES OF AMERICA,
Defendant

JUDGMENT

A judgment having been entered herein on November 14, 1968, in favor of the plaintiff on his claim and against the defendant on its counterclaim, and an appeal having been taken from that judgment by the defendant, and the United States Court of Appeals for the Fifth Circuit in an opinion and judgment entered July 8, 1970, having reversed said judgment and remanded this cause for further proceeding in accordance therewith, and this cause having come on for hearing before the Court pursuant to mandate of the Court of Appeals on June 28, 1971, it is, in conformity with the findings of fact and conclusions of law of this Court on remand, hereby,

ORDERED, ADJUDGED and DECREED that the judgment of this Court of November 14, 1968, be and the same is hereby vacated, and it is

FURTHER ORDERED, ADJUDGED and DECREED that the plaintiff, J. A. Newsome, Jr., take nothing by his claim and that the defendant, United States of America, on its counterclaim, have and recover judgment of J. A. Newsome, Jr. in the amount of $18,735.71, plus interest thereon according to law from July 16, 1965, and it is

FURTHER ORDERED, ADJUDGED and DECREED that the defendant have its costs of action incurred in this Court.

DONE at Houston, Texas, this 23rd day of September, 1971.

JOHN V. SINGLETON, JR.
United States District Judge

APPROVED AS TO FORM:

ROBERT I. WHITE
Robert I. White
Chamberlain, Hrdlicka, White
& Waters
Bank of the Southwest Building
Houston, Texas 77002

ATTORNEY FOR PLAINTIFF

ANTHONY J. P. FARRIS
United States Attorney

By HOWARD A. WEINBERGER
Howard A. Weinberger
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Dallas, Texas 75202

ATTORNEY FOR DEFENDANT

APPENDIX D

IN THE
UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 71-3621

J. A. NEWSOME, JR.,
Plaintiff-Appellee-Cross Appellant,

versus

UNITED STATES OF AMERICA,
Defendant-Appellant-Cross Appellee.

Appeals from the United States District Court for the Southern District of Texas

---

(November 22, 1972)

Before GEWIN, BELL and GODBOLD,
Circuit Judges.

PER CURIAM: The judgment of the district court is affirmed on the appeal and cross appeal. The costs shall be divided equally between the parties.

AFFIRMED.

APPENDIX E

UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

October Term, 1972

No. 71-3621

D. C. Docket No. 67-H-404

J. A. NEWSOME, JR.,
Plaintiff-Appellee-Cross Appellant,

versus

UNITED STATES OF AMERICA,
Defendant-Appellant-Cross Appellee.

Appeals from the United States District Court for the Southern District of Texas

---

Before GEWIN, BELL and GODBOLD, Circuit Judges.

JUDGMENT

This cause came on to be heard on the transcript of the record from the United States District Court for the Southern District of Texas, and was argued by counsel;

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court that the judgment of the said District Court in this cause as to both the main

appeal and the cross appeal be, and the same is hereby, affirmed;

It is further ordered that plaintiff-appellee-cross appellant be condemned to pay one-half of the costs on appeal to be taxed by the Clerk of this Court; and that defendant-appellant-cross appellee be condemned to pay one-half of said costs.

November 22, 1972

Issued as Mandate: December 14, 1972

APPENDIX F

INTERNAL REVENUE CODE OF 1954 (26 U.S.C.):

Sec. 6671. Rules for Application of Assessable Penalties.

(a) *Penalty Assessed as Tax*—The penalties and liabilities provided by this subchapter shall be paid upon notice and demand by the Secretary or his delegate, and shall be assessed and collected in the same manner as taxes. Except as otherwise provided, any reference in this title to "tax" imposed by this title shall be deemed also to refer to the penalties and liabilities provided by this subchapter.

(b) *Person Defined.*—The term "person", as used in this subchapter, includes an officer or employee of a corporation, or a member or employee of a partnership, who as such officer, employee, or member is under a duty to perform the act in respect of which the violation occurs.

Sec. 6672. Failure to Collect and pay over tax, or attempt to evade or defeat tax.

Any person required to collect, truthfully account for, and pay over any tax imposed by this title who willfully fails to collect such tax, or truthfully account for and pay over such tax, or willfully attempts in any manner to evade or defeat any such tax or the payment thereof, shall, in addition to other penalties provided by law, be liable to a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over. No penalty shall be imposed under section 6653 for any offense to which this section is applicable.

Sec. 7501. Liability for taxes withheld or collected.

(a) *General Rule.*—Whenever any person is required to collect or withhold any internal revenue tax from any other person and to pay over such tax to the United States, the amount of tax so collected or withheld shall be held to be a special fund in trust for the United States. The amount of such fund shall be assessed, collected, and paid in the same manner and subject to the same provisions and limitations (including penalties) as are applicable with respect to the taxes from which such fund arose.

* * *

APPENDIX G

NO. 22,926

IN THE
UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

Robert G. Dudley, *Plaintiff and Appellant*

vs.

United States of America, *Defendant and Appellee.*

On Appeal from the Judgment of the United States District Court for the Northern District of California

APPELLEE'S PETITION FOR REHEARING

To the Honorable United States Court of Appeals for the Ninth Circuit and the Honorable J. Warren Madden, Senior Judge, United States Court of Claims, and the Honorable John F. Kilkenny and Ozell M. Trask, Circuit Judges thereof:

Comes now the United States of America, the defendant-appellee in the above-entitled cause, by its attorneys, and presents this, its petition for rehearing in the above-entitled cause, in which an opinion was filed on July 7, 1970, reversing the judgment of the District Court and remanding the case to the District Court with directions to grant appellant's claim for refund and to dismiss the appellee's counterclaim, and in support thereof respectfully presents the following reasons:

This case involves the extent to which the president of a corporation which has withheld federal income taxes from the salaries of its employees is personally liable when

the corporation fails to pay such withheld taxes over to the United States. On successive days, two Courts of Appeals rendered opinions stating greatly different legal principles regarding the enforcement of this "responsible officer" liability. This Court decided the instant case on July 7, 1970, and *Newsome v. United States* (70-2 U.S. T.C. ¶9504), was decided by the Fifth Circuit on July 8, 1970. (No. 27,613.)

The salient portion of this Court's opinion, illustrating the basis of its reasoning, is as follows (Slip Op. 6-7):

> From the time that he [Dudley] learned of the bank's refusal to pay the check, it can be said that he willfully failed to pay over the tax due to the IRS. He also willfully failed to pay the corporation's withholding tax for the second calendar quarter of 1960 which became due on July 31, 1960. We find, however, that beginning at a time before Dudley received knowledge that the May 2 check had been dishonored, Dudley had ceased being the "person" in the corporation "required to collect, truthfully account for, and pay over" the withholding taxes, as defined in 26 U.S.C. §§ 6671(b) and 6672.

This Court, thus, examined Dudley's status as a responsible officer and his willfulness in failing to pay the withheld taxes over to the Government for both the first and second quarters of 1960 only as of the date payment was due, not beginning as of the time the taxes were withheld from the employees' salaries. The instant decision, therefore, is based on the premise that a responsible officer has no duty with respect to the collected taxes prior to the date the taxes are due to be paid over to the Government. This method of analysis, it is respectfully sub-

mitted, is inconsistent with the relevant statutory provisions concerning the withholding of federal taxes. See Sections 6671(b), 6672, and 7501 of the Internal Revenue Code of 1954. The Fifth Circuit stated the correct principles in its recent decision in *Newsome v. United States, supra,* Slip Op. 6-8:

> In many of these cases, a responsible officer's "willfulness" is established by the knowing preference of other corporate creditors over the United States *after* the due date for the corporation to remit the withheld taxes. However, liability under section 6672 can also be premised upon use of withheld funds for other corporate purposes *before* the date for the corporation to pay over the funds.
>
> The taxes withheld from employees' wages are held by the corporation as a special fund in trust for the United States. Section 7501; see *Monday v. United States,* 421 F.2d 1210, 1214 (7 Cir. 1970); *United States v. Hill,* 368 F.2d 617, 621 (5 Cir. 1966). Although Section 7501 does not require a corporation to segregate the withheld taxes from its general funds, it is clear that the withheld taxes are more than simply a debt of the corporation.
>
> Since a corporation can act only through its agents —its officers and those designated by the officers— a corporate officer or agent has a duty to see that withheld funds are properly collected from the employees, are maintained during the quarter, and are paid over to the government at the end of the quarter. This duty, for purposes of section 6672 liability, is a continuing one which arises when the federal income and social security taxes are withheld from employees' wages and ends when such funds are paid over to the United States.
>
> The responsible officer's actions before the due date for payment of the withheld taxes satisfies the

"willfulness" requirement under section 6672: when the responsible officer (as defined by section 6671 (b)) knows that the withheld funds are being used for other corporate purposes, regardless of his expectation that sufficient funds will be on hand on the due date for payment over to the government. Of course, the officer is only liable under section 6672 if the corporation does not pay over the withheld taxes at the date prescribed in the regulations. However, he subjects himself to liability under 6672 when he voluntarily and consciously "risks" the withheld taxes in the operation of the corporation, and subsequently the corporation is unable to remit the withheld taxes.

One example of using withheld taxes for other corporate purposes would be when, at any time during the quarter, the responsible officer is aware that the amount of corporate funds is lower than the amount of taxes withheld for the quarter and allows, or has knowledge of, the corporation's continuing to pay other corporate creditors. (Footnotes omitted.)

When these principles are applied to the instant case, it is clear that Dudley is personally liable for the withholding taxes. He was the corporation's chief executive officer with the final word as to what creditors should or should not be paid until, at the very earliest, the middle of June, 1960. (I-R 50; Slip Op. 7-8.) Throughout this period, Dudley preferred other creditors to the United States by using the withheld taxes to pay them instead of setting such funds aside as required by Section 7501. (See, e.g., I-R 65-66.) Dudley was gambling with money due the Government, that the corporation would generate sufficient income to pay the taxes when due. This action is the same as the use of withheld funds for other corporate purposes with the expectation that sufficient funds will be

available on the date payment was due the Government which was held to constitute willfulness in *Newsome*. Dudley's willfulness was established at this point. His later, unsuccessful, attempt to pay the tax for the first quarter of 1960 by drawing a $7,466.21 check on an account with a deficit of $1,761.14 (I-R 49; Ex. 1-F) simply compounded the gamble. In so acting, Dudley, not the Government, consciously took the risk that there would be insufficient revenue to cover the check upon presentment or that the bank would not honor his overdraft. This action neither insured his gamble nor vitiated his existing willfulness. It should also be noted that this Court (Slip Op. 6) agreed that Dudley's actions for the second quarter, which were identical to those for the first except for the attempted payment, did constitute willfulness.

The responsibility for payment of taxes collected arises immediately upon the collection of those taxes, not on the date the statute requires that they be paid over to the Government, and this responsibility continues until the Government is actually paid. Any other interpretation of the statute would ferment considerable evasion of tax liability. For example, a corporation could be forced into bankruptcy near the end of the taxable period. The trustee would then have the sole power over corporate finances, and this would eliminate the duty of a prior responsible officer to pay over all federal taxes withheld prior to the appointment of the trustee. This result is avoided when the questions of the identity of a responsible officer and of his willfulness are determined beginning as of the date the federal taxes are withheld from employees' salaries rather than as of the date payment is due to the Govern-

ment. Cf. *Tiffany v. United States,* 228 F. Supp. 700 (N.J., 1963).

It is requested that this Court reexamine the instant case in light of the principles set forth in *Newsome v. United States* and in this petition for rehearing, and upon such reexamination, affirm the judgment of the District Court.

Respectfully submitted,

LEE A. JACKSON,
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MEYER ROTHWACKS,
ELMER J. KELSEY,
STEPHEN H. HUTZELMAN,
Attorneys,
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Washington, D. C. 20530.

In the Supreme Court of the United States

OCTOBER TERM, 1972

No. 72-1145

J.A. NEWSOME, JR., PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The first opinion of the district court is reported at 301 F. Supp. 757. The opinion of the court of appeals, reversing and remanding the case, (Pet. App. 15-27), is reported at 431 F. 2d 742; the opinion denying a petition for rehearing with a suggestion of rehearing *en banc* is reported at 431 F. 2d 749. On remand the district court wrote no opinion. The opinion of the court of appeals affirming *per curiam* the judgment of the district court (Pet. App. 35), is reported at 468 F. 2d 1399.

JURISDICTION

The judgment of the court of appeals was entered on November 22, 1972 (Pet. App. 36-37). The petition for a writ of certiorari was filed on February 20, 1973. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether the court of appeals applied correct legal principles in determining that petitioner, concededly a "responsible" officer, was liable for the penalty provided by Sections 6671 and 6672 of the Internal Revenue Code of 1954 for failure to pay over withheld taxes.

STATUTES INVOLVED

The pertinent provisions of Sections 3102, 3402, 6671, 6672 and 7501 of the Internal Revenue Code of 1954 (26 U.S.C. (1958 ed.)) are set forth in the Appendix, *infra*, pp. 9-10.

STATEMENT

Petitioner, as president of New Wolf Construction Company, is conceded to have been a responsible officer of that corporation within the meaning of Sections 6671 and 6672 of the Code. Upon default by New Wolf in payment to the government of withheld taxes, the shortages were assessed against petitioner under the provisions of Section 6672. Petitioner paid a portion of the assessed taxes and filed a suit for refund, after which the government counterclaimed for the balance due. (Pet. App. 15-16.) At the first trial the undisputed evidence showed that, when petitioner examined New Wolf's November financial statements on December 27, 1961, the withheld taxes owed to the government were approximately $20,700 and the cash then available for satisfaction of this liability was $7,739.59. (Pet. App. 25-26.) During January, 1962, more than $64,000 was deposited to New Wolf's account (Pet. App. 26, fn. 14); despite his knowledge of the liability for the withholding payments, however, petitioner permitted New Wolf to pay its creditors other than the government (Pet. App. 26).

On January 29, 1962, petitioner was informed that New Wolf did not have sufficient funds to pay the withholding

liability due for the quarter ending December 31, 1961, and, on advice of counsel, he sent to the Internal Revenue Service the required return form with an explanatory letter that full payment of the amount due would be made shortly. Thereafter, and until February 14, 1962 (at which time he ceased to have control over New Wolf's financial operations (Pet. App. 16)), petitioner continued to allow New Wolf to make substantial payments to creditors (including himself) other than the government. (Pet. App. 24, 27.)

Notwithstanding these facts, the district court held that taxpayer's reliance upon the advice of counsel was sufficient "reasonable cause" to negate a willful failure to pay over the withheld taxes within the meaning of Section 6672 of the Code. The court of appeals reversed, pointing out that petitioner's counsel had never advised him that he could legally pay out New Wolf's funds to non-government creditors without subjecting himself to liability under Section 6672 (Pet. App. 24-25, 27), and remanded the case for a determination of the amount of the judgment. (Pet. App. 27, fn. 16.) Petitioner's petition for a rehearing was denied. (Pet. App. 28-32.) After a hearing in the district court, judgment was entered in favor of the United States in the amount of $18,735.71. (Pet. App. 33-34.) Both petitioner and the government appealed to the court of appeals. The court of appeals affirmed, without opinion, the judgment of the district court. (Pet. App. 35.)[1]

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[1]The government has not sought a writ of certiorari with respect to that portion of the court of appeals decision adverse to it.

ARGUMENT

The decision below, holding that petitioner willfully failed to pay over the withheld taxes in question, is correct. There is no conflict or other reason for further review.

1. Under Sections 3102 and 3402 of the Internal Revenue Code of 1954, Appendix, *infra*, an employer is required to withhold federal income and social security taxes from the wages of his employees. These withheld funds, which are held by the employer as a collection agent for the government, constitute a special trust fund in favor of the government, Sec. 7501 of the Code, Appendix, *infra*, p. 10, and are not ordinarily considered funds available for distribution to the company's creditors.[2] Where the employer has withheld income and social security taxes, the employee is credited with payment of the appropriate amounts to the government and, unless the government has recourse against the responsible officer, when the amounts are not paid over to the government by the corporation, the tax is lost. *Dillard* v. *Patterson*, 326 F. 2d 302 (C.A. 5); *United States Fidelity & Guaranty Co.* v. *United States*, 201 F. 2d 118, 120 (C.A. 10). In order to insure that the government does not suffer such a loss, Section 6672 of the Internal Revenue Code, Appendix, *infra*, provides, that any person required to withhold and pay over these taxes (*i.e.*, a "responsible officer") who willfully fails to do so is liable for a penalty equal to the amount of the delinquency.

2. Petitioner argues that the decision below is in conflict with the rule in other circuits; in support of this con-

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[2]This may not be true after an employer who has failed to segregate the withheld taxes goes into bankruptcy, *United States* v. *Randall*, 401 U.S. 513. See *infra*, pp. 6-7.

tention, petitioner cites, for example, language from *Bloom* v. *United States*, 272 F. 2d 215, 223 (C.A. 9), certiorari denied, 363 U.S. 803, to the effect that willfullness under Section 6672 entails a "voluntary, conscious, and intentional act." (Pet. 7.) While petitioner is correct in stating that this is the rule followed and adopted in other circuits, it is also the rule followed by the Fifth Circuit in the instant case.[3] Petitioner's assertion of a conflict seems to rest upon a construction of the language quoted from *Bloom* as meaning (Pet. 13) that the responsible officer must intend that the payments which he makes to other creditors will cause the government to be deprived of its taxes. This is not, however, what was meant by the Ninth Circuit in *Bloom*, or by the other circuits following that precedent. Rather, the requisite willful preference is made when the officer pays other creditors at a time when he knows the United States has a present claim for the funds held by the employer subject to the Section 7501 trust. It is not relevant whether the officer has an intention to deprive the United States of its taxes (see *Monday* v. *United States*, 421 F. 2d 1210, 1214-1215 (C.A. 7)), or whether he hopes or expects that ultimately funds will become available to pay the government. Indeed, the facts here are in the same pattern as in *Bloom* and the other cases cited by petitioner, and we suggest that the same result would have been reached by those courts had the instant case been before them. The only payments for which petitioner has been held liable are those made by him after December 27, 1961, the date on which he was apprised that there were insufficient funds on hand to pay the withholding taxes for the fourth quar-

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[3]Significantly, the language quoted from *Bloom* is the same language used by the Fifth Circuit in its first opinion in the instant case. 431 F. 2d. at 745.

ter of 1961.[4] With respect to the payments made to creditors after that date, petitioner's counsel did not, as the court of appeals noted, *supra,* p. 3, advise petitioner that these payments could be made without the risk of liability under Section 6672.

3. Petitioner also contends (Pet. 9-10) that the decision below is in conflict with *United States* v. *Randall,* 401 U.S. 513. In *Randall,* this Court held that, in a bankruptcy situation, Section 64(a)(1) of the Bankruptcy Act (11 U.S.C. 104(a)(1)), which provides a special priority for expenses incurred in administering a bankrupt's estate, preempts even the special right of the government to funds held in trust by the bankrupt pursuant to Section 7501(a) of the Code. That holding, which emphasized repeatedly the importance of honoring in bankruptcy proceedings the priorities explicitly set forth in the bankruptcy laws, does

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[4]While we believe that there may be an inconsistency in approach between the Fifth Circuit's decision in the instant case and that of the Ninth Circuit in *Dudley* v. *United States,* 428 F. 2d 1196 (see the government's petition for rehearing in *Dudley*) (Pet. App. 40-45), the decision in the latter case seems to have been controlled by the very special circumstance that the responsible officer there had issued a check to the Internal Revenue Service covering the taxes due and the check was dishonored by the bank for reasons which the appellate court noted were not clear. The court was impressed by this and by the fact that the government was dilatory in presenting the check for payment and failed to notify the responsible officer that it had been dishonored. As the court pointed out, other funds were available after the date of issuance of the check from which the officer could have satisfied the government's claim if he had been timely notified of the dishonor. In view of the fact that, in other cases (notably *Bloom, supra*), the Ninth Circuit has taken a position which is in line with that of the Fifth Circuit here, and since the special facts in *Dudley,* with respect to which the government did not seek certiorari, tended to prevent a square presentation of the point at issue here, there is no reason to believe the Ninth Circuit would not have reached the same result as did the Fifth Circuit on the facts of the instant case.

not undermine the principles upon which the court below and other courts of appeals have relied in interpreting Section 6672 of the Code outside the context of bankruptcy.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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APRIL, 1973.

APPENDIX

Internal Revenue Code of 1954 (26 U.S.C. (1958 ed.)):

SEC. 3102. DEDUCTION OF TAX FROM WAGES.

(a) *Requirement.*—The tax imposed by section 3101 shall be collected by the employer of the taxpayer, by deducting the amount of the tax from the wages as and when paid. * * *

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SEC. 3402. INCOME TAX COLLECTED AT SOURCE.

(a) *Requirement of withholding.*—Every employer making payment of wages shall deduct and withhold upon such wages * * * a tax equal to 18 percent of the amount by which the wages exceed the number of withholding exemptions claimed, multiplied by the amount of one such exemption as shown in subsection (b)(1).

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SEC. 6671. RULES FOR APPLICATION OF ASSESSABLE PENALTIES.

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(b) *Person Defined.*—The term "person", as used in this subchapter, includes an officer or employee of a corporation, or a member or employee of a partnership, who as such officer, employee, or member is under a duty to perform the act in respect of which the violation occurs.

SEC. 6672. FAILURE TO COLLECT AND PAY OVER TAX, OR ATTEMPT TO EVADE OR DEFEAT TAX.

Any person required to collect, truthfully account for, and pay over any tax imposed by this title who

willfully fails to collect such tax, or truthfully account for and pay over such tax, or willfully attempts in any manner to evade or defeat any such tax or the payment thereof, shall, in addition to other penalties provided by law, be liable to a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over. No penalty shall be imposed under section 6653 for any offense to which this section is applicable.

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SEC. 7501. LIABILITY FOR TAXES WITHHELD OR COLLECTED.

(a) *General Rule.*—Whenever any person is required to collect or withhold any internal revenue tax from any other person and to pay over such tax to the United States, the amount of tax so collected or withheld shall be held to be a special fund in trust for the United States. The amount of such fund shall be assessed, collected, and paid in the same manner and subject to the same provisions and limitations (including penalties) as are applicable with respect to the taxes from which such fund arose.

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